3:Kemeny G-5 (1945-48)1952 EC1 Hungary EC1

technical quality and in commercial organization. But they were growing in an atmosphere of protectionism, intensified in the thirties by a system of exchange regulations and import quotas, and they became dependent, with few exceptions, on a narrow national market. Consequently the competitive spirit was alien to the Hungarian entrepreneur. He did not naturally think of extending markets by reducing costs and prices, and was rather monopolistically minded, bent on securing profits by charging high prices. Thus the tendency, then prevailing internationally, of industrial and agricultural prices to diverge to the disadvantage of the latter, had been accentuated. These developments furthered industrial expansion, enabling industrialists to extend their capital by ploughing back considerable profits. In the absence of a capital market this was virtually the only way of financing. High industrial profits, however, caused discord, sharpened antagonism between the different classes of society, and made industry and industrial capitalism unpopular.

Industrial development implied decreasing imports of finished products. But Hungarian industry was, as it still is, largely dependent on imported raw materials, particularly on imports of timber, metals, and cotton. Industrial production cannot be carried on unless the necessary materials can be paid for by exports. The exports had, moreover, to cover the deficit in the invisible items of the balance of payments. On the average of the period 1933–7, 44 per cent of the total imports consisted of raw materials, 29 per cent of semi-finished products, and 27 per cent of wholly manufactured goods. Of exports, roughly 60 per cent were unprocessed food—wheat, cattle, pigs, poultry—and raw materials, 10 per cent semi-finished products, and 30 per cent manufactured articles. During the period in question exports amounted to about 12 to 13 per cent of total national production.

The productive capacity of Hungarian industry was enlarged between 1938 and 1943 by the launching of a public investment programme. Yet the consumptive power of the country was not extended: it was, in fact, contracted by the steadily increasing inflation. The expansion of industry during these years was, of course, part of the effort of rearmament, and was also intended to feed the insatiable appetite of the Third Reich.

The war made inroads on the country's enlarged industrial capacity through bombing, through damage inflicted during the campaign of 1944–5, and through Russian dismantling in the first phase of the occupation. It was not capacity, however, which set limits to production after the end of the war. The decisive limitation was the lack of coal and raw materials along

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In order to improve industrial production, the problem of foreign trade had to be tackled. Dislocation brought about by the war led to a complete breakdown of international trade. In 1946 the volume of imports as well as of exports amounted to about one-sixth of the pre-war level.

The efforts in securing raw materials scored some success. In 1947 imports were raised to about half of the pre-war volume, yet exports did not exceed one-quarter. There were remarkable shifts in the composition of foreign trade, reflecting the changed conditions. Imports appear to have been restricted to raw materials and industrial equipment, while manufactured goods figured as the main items of exports in consequence of the shortage in all kinds of farm products.

Two major factors (war losses and drought) affecting agricultural production have been mentioned. There was a third one, a direct consequence of the political landslide: the breaking up of the big estates and of the big holdings of which they mostly consisted. In their place several hundred thousand of new peasant holdings emerged.[1] This radical change, brought about by the land reform of 1945, inevitably caused a lessening of the marketable portion of farm produce. The land reform was bound to alter the old pattern of agricultural production. In its wake the preponderance of grain growing was expected to give way to a more diversified cultivation. Corresponding with these changes in the composition of production, the exportable surplus of cereals was destined to cease and was to be replaced by the products of more labour-intensive peasant farming. But the process of recovery in farming being necessarily slow, agriculture was overtaken by the extension of industrial production even before the Plan was started. Consequently farming lost its previous importance as a main source of exports.

Post-war reconstruction was to be achieved under unprecedented conditions. After the collapse of the Fascist regime, public services had to be rebuilt and work discipline restored under Russian occupation in a radically changed social atmosphere. Economic policy was bound to reckon with new developments in agriculture and industry as well as with the necessity of a reorientation of foreign trade. Last but not least there was the urgent task of halting inflation, as financial disorder attained proportions which endangered the entire social and economic fabric.

[1] This involved also the splitting up of production units, the large estates having been run mostly as large-scale farms and only exceptionally in the form of small tenancies.

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MONETARY REFORM

458 In the economic history of post-war Hungary August 1946 was a turning point. The country was drifting towards complete anarchy under the impact of an inflation the speed of which during the first half of 1946 surpassed anything hitherto experienced in this field. Its effects on the currency were devastating; it overthrew the entire price structure. In some respects the heavy strain placed upon the whole economic and social fabric by the intolerable wave of inflation helped to clear away difficulties in the way of the coming monetary reform. The accelerated collapse of the monetary system reinforced the intense desire for a return to a state of normality. Thus a psychologically favourable atmosphere for a new currency was created. Nevertheless it was a dangerous gamble with anarchy.

652 From a psychological point of view it was also relevant that the gold and foreign exchange reserves of the Hungarian National Bank (representing the value of 32 million dollars), which had been removed by the retreating Germans, were traced in the United States Occupation Zone of Germany, and returned in time by the United States authorities. Skilful propaganda advertised that the new currency would be backed by gold reserves at a pre-war rate (with a minimum of 25 per cent). The new monetary unit was defined in terms of fine gold contents,[1] but convertibility into gold was, of course, neither established nor ever intended. The obligation was imposed on the National Bank to see to the stability of the currency. The denomination of the new monetary unit—forint (florin)—was chosen so as to recall the tradition of the stable florin of Habsburg days, which was still remembered by the older generation.

At the outset it was the restricted supply of the new currency that induced the public to feel confidence in it. The value of the huge amount of pengö notes was practically annihilated, as their depreciation went far ahead of the pace of their issue. The supply of money depended, therefore, on the issue of forint notes. There was an initial issue of 300 million, to give the Treasury a breathing space until the reform of taxation became operative. The amount of 300 million forint was but a fraction of monetary requirements on the basis of prices and wages, which had been fixed in advance by reference to the price structure in 1938 as a 652 starting point. Nevertheless strict deflationary credit practices 457 were maintained at the beginning, compelling trade and industry to sell off stocks and also reserves of foreign exchange. Holders of foreign exchange were encouraged to offer it to the

[1] 1 forint = 0·0757 gramme of fine gold.

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[651] budget year. Eventually 360 million forint had to be raised by 652 borrowing (60 million through the Postal Savings Bank in addition to the initial National Bank loan of 300 million) and 450 million from other extraordinary sources of revenue.[1]

The supply of currency, as reflected in the issue of bank-notes, is shown by the following figures:

	Million forint
31 August 1946	355·6
30 September 1946	606·6
31 January 1947	1,016·8
30 April 1947	1,258·2
31 July 1947	1,592·2

652 The renewed expansion of the circulation might prompt the 457 question whether the public, with the recollection of their recent experiences, would once again begin to distrust the currency. The stabilization was strictly confined to the internal value of money. In Hungary a system of exchange control had been in force as far back as 1931. This control naturally was taken over and maintained when an economy of shortage supervened at the end of the war. Transactions arising out of foreign trade were based on official parity rates in conformity with bilateral agreements.

In spite of heavy penalties a black market for foreign exchange and gold developed with rising rates. Apart from prosecuting the participants, in so far as they could be caught, the authorities did not interfere with the black market. There was, in particular, no direct intervention to influence the rates of this market. They were regarded by the authorities as isolated phenomena, unlikely to affect the general economic situation. This view was on the whole justified, for transactions in the black market were negligible.

652 However, by the autumn of 1946 an additional difficulty [458] arose, endangering the balance between the amount of currency and the stream of goods. The poor harvest and the deficiencies of administration resulted in an acute food shortage and soaring prices. These price increases undermined confidence in the monetary reform, and black-market rates of exchange rose correspondingly. The upward movement was halted by a temporary credit restriction. A similar stiffening of the position developed in March 1947 in connexion with new difficulties in food supplies. It was checked by the same weapon of short-lived deflation. This was effected by enforcing the maximum limit of the note issue and by giving instructions to the National Bank

[1] These consisted mainly in the profit from the revaluation of the National Bank gold reserve and in the proceeds of the sale of goods obtained within the framework of UNRRA relief and the U.S.A. loan in kind.

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to apply stricter principles of selection, especially in regard to the maturity of bills discounted. Though in both cases only temporary success could be achieved, the Government managed to demonstrate that not only upward movements but also setbacks in commodity prices and in exchange rates on the black market might occur. This proved to be sufficient to stave off an inflationary disposition. The effects of the uneasy balance established were not far-reaching enough to stimulate saving and accumulation of capital in the form of money. It was not monetary developments, however, that primarily impaired private savings, but much rather the extremely low level of incomes and the lack of political confidence on the part of the limited number of persons with higher incomes. Yet the currency created by the reform of August 1946 performed its functions as a medium of exchange satisfactorily. No doubt inflationary pressure was present in 1946–7 as well as later on, more intensely in the event of poor crops and less so when food supplies were adequate.

Summing up, the monetary reform did not succeed in creating a completely stable currency. But it did end a period of fantastic inflationary excesses by establishing a financial system kept under control, and it presented the planners with an instrument which, though far from perfect, was nevertheless useful enough for their purpose. A basis for economic calculation was created, though in the case of long-term plans allowance had still to be made for changes in the price level. Last but not least, the new monetary system, though incomplete when measured by the stricter standards of economic theory, was, after the experience of the past, appreciated by the workers and the peasants. Beyond doubt the new currency contributed to the improvement of labour productivity. Thus the measures carried through in the field of finance in 1946–7 were with good reason regarded as a preparatory step for the introduction of a planned economy.

A NEW PRICE STRUCTURE—DEFICIENT CONTROLS

In view of acute shortages, the fabric of the economic control introduced during the war was maintained in post-war Hungary. Exchange regulations were coupled with a system of import quotas. The supply of raw materials, whether foreign or domestic, was allocated among users by the authorities. In 1946–7 rationing comprised all important sorts of food and certain other products like domestic fuel and soap. But, with supplies quite inadequate, food rations were fixed at levels covering

3:Kemeny G-5 (1945-48)1952 EC1 Hungary EC1

464 the fact that in the course of seven years the number of the working population increased by some 200 thousand seems to indicate, even after taking account of possible extension of employment in professions outside industry, an agricultural man-power reserve of 360 to 400 thousand and a total unutilized reserve of 400 to 440 thousand if industrial unemployment is included.

The estimate of 400 to 440 thousand is practically applicable to the year 1938, with an employment of 330 thousand in mining and manufactures. That year, being accepted in the Report of the National Planning Department as representative for pre-war conditions, can be appropriately used as the base year in estimating the extent of the man-power reserves to be absorbed.[1]

There is still the question whether it is justifiable to accept pre-war estimates of man-power reserves when seeking to measure the scale of utilization of these reserves under the Plan.

[161] Total population, numbering 9·20 million by the end of 1948, was slightly greater than that of 1938 (9·10 million). The war and its aftermath, together with the massacre of Jews, approximately offset the natural growth of the population during a decade. None the less shifts possibly occurred in the number of actively employable persons. The demand for labour in agriculture must have been, in particular, influenced by post-war conditions. Shortage of technical equipment and the urgent need of constructing accommodation on the newly-formed holdings were bound to create an extra demand for hands during the early post-war period. This extra demand had presumably begun to subside by the time the Plan started. Later on the progress of mechanization (establishment of tractor stations) and the improved supply of labour-saving equipment might have diminished the demand for labour. But the impact of the sub-

[1] In this context the question might be raised, is it justified to regard conditions in 1938 as representative, and, therefore, to choose this year as a basic period. In defining the economic position in this year the following facts have to be considered. Subsequent to the world economic crisis the turn of the tide was dated in Hungary from 1934. The upward trend gathered momentum during the years 1935–7, industrial employment showing higher records by the end of this period than during the boom of the twenties. The upward movement flattened out and the curve even declined, in some industries, during the first half of 1938. Yet the effects of a gradual downward swing of the business cycle were offset by the impulses emanating from the armament and public-works programme launched in the second half of the year. The support given to the domestic market by public orders also cushioned the repercussions of a decline in exports caused by the slackening of international markets. Though at the time conditions appeared unsettled because of political crises, employment during the whole of 1938 was maintained. In the light of statistical evidence a state of affairs prevailing in 1938, according to Hungarian standards of the inter-war period, was regarded as fairly 'normal', though, of course, nothing like a full utilization of resources had been approached.

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neighbors, aimed at self-sufficiency. Industry was granted additional subsidies in the form of loans, cheap factory sites, and other measures. Together with low world market prices this policy was responsible for the depressed state of Hungarian agriculture from 1928 until about 1934, but all subsequent governments adhered to the industrialization program and frequently carried it further.

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The runaway inflation of the mid-twenties disrupted the country's finances, wiping out individual savings and ruining many companies.

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During the early twenties the Hungarian Oil Syndicate (an affiliate of the Anglo-Persian Oil Company) started explorations in western Hungary while the government carried out explorations east of the Danube. However, the Hungarian Oil Syndicate lost most of its exploration funds during the period of inflation and this coupled with unsuccessful drilling operations forced the company to abandon operations and pull out of Hungary. The government was also unsuccessful in this period, its only discovery that at Bükkszék, which resulted in the production of only 92,500 barrels over a thirteen-year period, much of it at an actual financial loss.

In 1933 the government granted a five-year concession for all areas west of the Danube to Eurogasco (an affiliate of the Standard Oil Company of New Jersey) in return for a pledge that $300,000 would be spent on prospecting and that at least eight wells would be drilled. Eurogasco's activities led to the discovery of the first commercial oil field in 1937 situated at Lispe, Zala County, near the old wells of the Mura district which were ceded to Yugoslavia in 1920. In 1940 a second field was developed nearby, at Lovászi. An eight-inch pipeline connecting the Zala fields with Budapest was completed in 1941. In that year Hungary reached self-sufficiency in oil production, and her 1943 output of 838,000 tons of crude contrasted with a (controlled) civilian consumption of only about 321,000 tons of refinery products (about 380,000 tons of crude equivalent). Table VI gives the civilian consumption for the years 1940-1943. More than half of the pro-

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1/ [Cf. page 88, category 116 -- Analyst]

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727 433 [434] only 186 were working at over 70 percent of prewar capacity, while 1,109, or over 25 percent, were completely out of operation. It is estimated that even in 1946/47 the national income was only 65 percent that of 1938 and less than 50 percent that of 1943, the peak war year. The Hungarian economy as a whole, and especially the industrial sector, heavily concentrated in Budapest, was among those most seriously damaged in Europe.

●[458] The Soviet occupation, heavy reparations payments, general political uncertainty, and a runaway inflation in 1946 made the task of reconstruction even more difficult.

728 471 648 According to the Potsdam agreement all Axis property, even that which had been forcibly taken over by the Germans during the war was handed over to the Soviet Union. Subsequently, new Soviet-Hungarian companies began to mushroom in manufacturing as well as in transportation, and it was at this time that the Hungarian-Soviet Oil Company, Maszovol, was organized.

727 315 [471] While the Zala fields had escaped major war damage they suffered by the wasteful practices engaged in under pressure from German and later Soviet military authorities (see Table VII).[1] After prolonged negotiations the MAORT properties (all areas west of the Danube) were returned to the American owners in 1946.

727 178 471 A land reform and the nationalization of industries "with monopolistic character" such as steel and coal were swiftly carried out after the war.

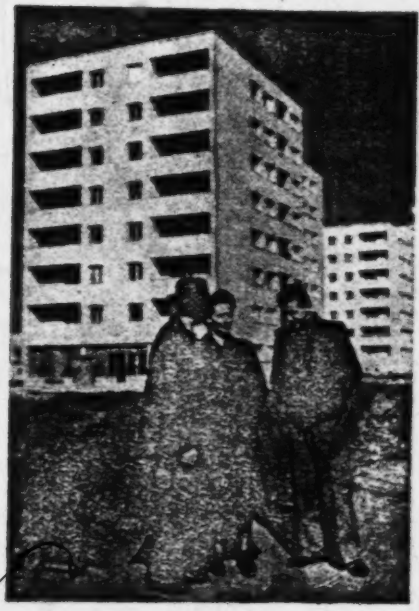
[565] Land reform, nationalization without compensation, and the inflation of 1946 largely destroyed the propertied classes, and in the chaotic conditions a downward leveling also affected the skilled workers.

[642] 727 185 [665] By mid-1947 the communists within the coalition government had virtually eliminated any possibility for non-communist government plans, and for all practical economic purposes the communists were in control. Dictated by the realities of the prevailing postwar conditions, certain

1/ [Cf. page 88, category 116 -- Analyst]

lap; none of it was given for nothing; none of it was obtained quickly, from one day to the next. He had to fight for this kind of life; it demanded self-discipline, hard work and a determined struggle against obstacles and difficulties.

What he had to do, however, he did not have to do alone but together with the others, with the entire country. Like the exciting scenes of a film drama, across his mind race the various incidents in the history of this small nation since its liberation.



This is No. 1 Peace Avenue, where Mr. Gergely has his apartment.

When the roar of the guns subsided and the people of Budapest came crawling out of the cellars, the first task was to clear away the ruins, the marks of the devastation caused by the war. Then they could begin reconstruction. They had to rebuild ruined factories, plants, machines, replace losses —the Nazis had taken away everything that was movable — produce coal, iron, raw materials; start transportation; produce, work and struggle against the enemy, who did their best to bring back the past, the oppression of the working class, and the wealth acquired without work by the privileged few.

Ferenc Gergely's face darkens when he remembers the terrible chaos of inflation, when the wages received for a week of hard work scarcely paid for two pounds of sauerkraut. The horse-dealers, stock exchange sharks, black marketeers and speculators lived like kings and spent their

[16, Hungarian Iron-worker --- Analyst]

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Sunday morning at home.

458 gold in expensive restaurants and nightclubs. The mag-
435 nates, the landlords, the fascist army officers, allied to all kinds of traitors of the working class movement, were conspiring and organizing underground to prevent the working people from rebuilding the country for themselves, for their own prosperity.

000 But they could not turn history back. The Hungarian working class was vigilant and strong, determined and untiring. Its fist was quicker and harder! Its persistance and heroic effort was crowned with success. The three year plan of reconstruction was achieved ahead of time (1947-49), and this permitted the launching of a plan on an even larger scale, the plan to build an entirely new Hungary. The Five Year Plan is the pride of the millions of Hungarians.

[327] Ferenc Gergely, together with thousands of his fellow
461 workers, works on Csepel Island in Budapest, in the largest industrial plant of the country. He is no stakhanovite, not even a decorated worker. Only the best, the most

161 This trend ? was aggravated by the fact
458 that Hungary was such a densely populated state. The
241 density of her population amounted to almost 100 people per square kilometre. Due to the low agricultural prices prevailing generally in the world, to the keen foreign competition and to her dependence upon the exportation of raw products it was almost impossible adequately to maintain the agrarian population by the cultivation of the soil.

728 While her old Austro-Hungarian market of 58 million
439 people was reduced to a market of 7·5 million, she was
652 burdened in addition with large foreign debts which could only be paid by agricultural exports. Owing to political considerations, the surrounding countries, instead of absorbing the Hungarian surplus products, boycotted her during the early post-war years. Added to this, the economic and other restrictions of the peace treaty made it impossible for Hungary to pursue an independent economic policy serving the true needs of the country. Not until eight years after the end of the first world war was the Government able to introduce an economic policy (industrialization, protective tariff system etc.) which could meet the challenge of the density of population and prevailing unemployment.

728 The difficulties of the post-war years were aggravated
464 by the existence within her borders of hundreds of thousands of refugees from former Hungarian territory. Our educated classes had grown numerically so great that it was practically impossible to find places for everyone in
652 the administration and economic systems. Millions had
185 to be spent on measures serving solely charitable purposes out of the proceeds of production and out of greatly decreased state receipts, which fell off as a result of the effects of the war. Therefore, for the first few years, no

? [i.e., a reversion to more primitive conditions -- Analyst]

planned social policy of bolder conception and projecting into the future could be instituted.

Social progress was obstructed also by other difficulties. The Government of Hungary consistently endeavoured to raise the living standards of the people. Several circumstances, beyond the control of political leadership, occasionally thwarted such efforts. When the period marked by the aforementioned economic boycott came to an end, several waves of depression swept over Europe, and by these Hungary was always seriously affected.

The liquidation of the post-war inflation was done under the financial supervision of the League of Nations, which meant that we did not enjoy full financial sovereignty. The same thing took place a second time after 1931 when the Central European economic and financial credit crisis occasioned new control. In spite of the exceptionally adverse conditions Hungary did not halt on her way to social advancement, but from the beginning the interests of social welfare constituted the key-note of her efforts to harmonize her economic and political life. In the enactment of all laws in the economic and financial sphere, social problems were given foremost consideration at all times during the past twenty years.

The march of social advancement was retarded at intervals by the world-wide depression, and therefore social conditions in Hungary could not progress all along the line as rapidly as was desired by the Government. Nevertheless the achievements have been great. In several respects, as we shall see, the social reforms were far in advance of those undertaken by larger and more wealthy nations, while again they can be considered as trail-blazers in some of their implications.

[cf., category 116, p.8 --- Analyst]

425 sional reform, but only by carrying out a continuous and
241 progressive programme.

The System of Protected Ownership.

241 The greatest blemish on the economic and social
426 structure of the agrarian community was the heavy in-
458 debtedness of the farmers. During the prosperous years after 1927 with their favourable prices and ready market, the farmers contracted extensive debts for making capital improvements in their land. The precipitous drop in farm income due to the financial crisis of 1931 left some of the farmers unable even to meet the interest payments on their debts. Wholesale foreclosures threatened, and the world-wide depression barred any hope of tens of thousands of farmers remaining secure in their tenure without outside help.
241 The Government, fully cognizant of the danger threatening
426 them, came to their rescue by first reducing the interest rate
652 on farm debts and then by prohibiting foreclosures. When these measures were found to be insufficient, the Government created the system of 'protected ownership' Under this system the interest payment relief and prohibition of foreclosures were continued and the Government also made provision for the definitive settlement of farm debts.

The small farmers were the ones who reaped the greatest benefits from this system. Among other grants-in-aid the Government paid gratuitously part of the short term bank debts of those farmers who cultivated less than 20 Hungarian acres of "protected" land. This was done before the general settlement of the farm debts took place, which covered these farmers also. During this settlement the Government assumed as a book debt that part of the farmers' indebtedness which was in

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selected from all major labor unions is headed by an ardent Communist, Kossa, organizer of the Budapest streetcar workers union.

An essential institution in Hungarian industry is the factory committee, elected by the workers to represent their interests in dealing with the management, or with State officials now serving as replacements for an almost extinct managerial class. These small factory committees are particularly sensitive to party ideology and are permeated by Communist propaganda. Through them the workers are brought into constant contact with political authorities of the State, and their private life is closely watched. At their trade union meetings they are given lectures on foreign and domestic politics devoted frequently to violent hate propaganda against Britain and the United States.[43] Trade unions and factory committees have thus become important tools in the hands of the country's dominant political-economic bloc.

The process of industrial recovery and the strengthening of a new laboring class have suffered considerably by the recent financial disaster which culminated in the inflation of 1946. The country's economic foundations were first weakened by the wave of German looting and seizures of valuable assets and capital goods, estimated at approximately ten billion dollars. The economic deathblow was then delivered by the prompt acquisitiveness with which Soviet Russia reduced occupied Hungary to the role of an economic colony. The threatening upward spiral of prices, wages and nominal money values finally drove out the Pengõ, discredited by a long and unchecked period of inflation. The economic situation improved substantially after the stabilization of August 1946 when an old Austro-Hungarian monetary unit, the *forint* (flŏrin), had been established as the fixed national currency. By the end of 1946 industrial capacity was gradually restored to about sixty percent of the pre-war potential, although Hungary continued to pay an exceedingly heavy reparation bill, both in industrial equipment and in current manufacturing production.[44]

Reparations today include nearly all of the country's capital goods

43 Cf. "Workers and Industry, Danubian Outlook," *The Economist*, Jan. 25, 1947, p. 134.

44 N. Káldor estimates that at least one-fourth of the total current production goes to the U.S.S.R. The reparations burden is further enhanced by a strict interpretation of the Potsdam agreement according to which the Russians continue to compute the reparations bill in "dollars of 1938 purchasing power." Nevertheless, Professor Káldor reaches the strange conclusion that "the picture of Soviet Russia as the ruthless economic exploiter of Hungary is far too one-sided." Cf. "The Danubian States," *The Times*, London, Nov. 19, 1946.